Annual Performance Report

2010-11

Newfoundland and Labrador Government
Sinking Fund

BOARD OF TRUSTEES
NEWFOUNDLAND AND LABRADOR CONSOLIDATED SINKING FUNDS

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
NEWFOUNDLAND AND LABRADOR MUNICIPAL FINANCING CORPORATION SINKING FUND

DEBT MANAGEMENT DIVISION
DEPARTMENT OF FINANCE
CONFEDERATION BUILDING
P.O. BOX 8700
ST. JOHN'S, NL
A1B 4J6

September 30, 2011

Message from the Board

I am pleased to present the Annual Performance Report for the Newfoundland and Labrador Government Sinking Fund for the 2010-11 fiscal year.

The Newfoundland and Labrador Government Sinking Fund administers the sinking funds established by the Province of Newfoundland and Labrador for the repayment of the Province's debenture debt. The effective investment and control of these funds is consistent with the Department's responsibilities with respect to stewardship of public money and management of the funded debt and supports the Department's strategic direction and commitment of sound financial management.

This performance report provides an overview of the Newfoundland and Labrador Government Sinking Fund and identifies key issues and results for the Board of Trustees during the fiscal year 2010-11. The Newfoundland and Labrador Government Sinking Fund earned a net income of approximately $48 million during 2010-11, which was net of a foreign exchange loss of $1.2 million, resulting from a decline in the value of the U.S. dollar.

The Board of Trustees is accountable for the preparation of this report and for the results reported therein.

Terry Paddon
Chairman

1.0 Overview

The Newfoundland and Labrador Government Sinking Fund was created pursuant to the *Financial Administration Act* to consolidate and administer sinking funds established for the repayment of the Province's debenture debt. The Province has established sinking funds for most of its long term debenture issues and the annual contributions to these sinking funds are invested by the Board of Trustees of the Newfoundland and Labrador Consolidated Sinking Funds, appointed by the Lieutenant Governor in Council to manage and control the day to day operation of the sinking funds. As at 31 March 2011, the Board of Trustees consists of the incumbents in five senior public service positions with the Department of Finance as follows:

Terry Paddon	Deputy Minister
Ronald Williams	Comptroller General
Robert Constantine	Assistant Deputy Minister Taxation and Fiscal Policy
Paul Myrden	Director, Debt Management
Linda Howell	Manager of Debt Servicing & Financial Risk

The Newfoundland and Labrador Government Sinking Fund operates with a March 31 fiscal year end and the results of its activities are fully consolidated in the Province's annual financial statements.

2.0 Mandate

The mandate of the Board of Trustees is to manage and control the operational activities of the Newfoundland and Labrador Government Sinking Fund and the sinking funds of certain Crown corporations where the Province has guaranteed the related debt (i.e. Newfoundland and Labrador Municipal Financing Corporation and the Eastern Regional Integrated Health Authority). These activities include setting investment policy, investment of funds and the monitoring of such. These funds are invested in accordance with the *Financial Administration Act,* primarily in bonds, debentures or other securities issued or guaranteed by the Government of Canada, the government of a province of Canada, or a chartered bank, with the goal of earning the maximum return from investment of the portfolio while ensuring security of the funds.

3.0 Sources of Funding

For debenture issues which have sinking fund requirements, the Province makes the required sinking fund contributions to the Board of Trustees. In 2010-11, these sinking fund payments amounted to $48,352,000. Sinking fund contributions are invested and the interest earnings, less an amount to cover administrative costs, are re-invested.

The Newfoundland and Labrador Government Sinking Fund's day-to-day activities are managed by employees of the Department of Finance and the Sinking Fund is invoiced quarterly by the Province for reimbursement of these expenses on a cost-recovery basis.

4.0 Financial Statements

The Newfoundland and Labrador Government Sinking Fund earned a net income of approximately $48 million during 2010-11, after a foreign exchange loss of $1.2 million, resulting from a decline in the value of the U.S. dollar. Any gains or losses resulting from foreign currency translations will not become realized until such time that the U.S. assets should ever actually be converted to Canadian dollars. Financial statements for the year ending 31 March 2011 are included in this report.

5.0 2008-11 Activity Plan Update

The Newfoundland and Labrador Government Sinking Fund supports the Department of Finance in its responsibilities related to stewardship of public money and fiscal management by the investing of funds in accordance with parameters set out in the *Financial Administration Act*. A review of the investment strategy of the fund was begun in 2007-08 and was completed in 2009-10. As part of this review, the three year activity plan of the NL Government Sinking Fund set forth the goal and objectives provided below. Please note that the original Activity Plan did not identify measures and indicators for the goal. The mandate of the Board of Trustees is very specific and clearly defined, making the work from year-to-year similar in nature. Therefore the development of a goal with measures and indicators as well as annual objectives also with measures and indicators was repetitive. Instead, the goal statement provided below was developed to summarize the work planned for the 2008-11 planning cycle.

Goal:
By March 31, 2011, the Newfoundland and Labrador Government Sinking Fund will have implemented any changes recommended to the investment strategy of the fund resulting from the review of that investment strategy and will have formally documented the investment policies of the fund.

Progress: During the period from 2008 to 2011, the Board undertook a review of the investment strategy of the sinking funds, with a view to determining if investment returns could be enhanced while continuing to ensure the security of the funds. The review process included discussions with investment dealers and fiscal agents of the Province and a review of two external documents prepared by investment firms which outlined possible changes to the investment strategy. Interviews were also held with other provincial jurisdictions to learn about their investment practices and a cost-benefit analysis was completed to assess the feasibility of expanding the types of securities purchased and taking a more active versus passive approach to the investing of the sinking funds. Historical yields of varied types of alternative securities were also reviewed.

Following completion of the review, the Board considered the options presented and concluded that no changes would be made to the investment strategy of the sinking fund at this time. The anticipated increases to the rate of return did not warrant the additional risk inherent in expanding the types of securities invested in or changing the manner of trading currently practiced.

Additionally, the investment policies of the Board were reviewed and updated where necessary on an annual basis.

2010-11 Objective:

By March 31, 2011 the Newfoundland and Labrador Government Sinking Fund will have completed an annual review of the investment strategy and policies of the sinking fund.

Measure: Review of investment strategy and policies
Indicator: Review completed

Progress: The annual review of the investment strategy and policies has been completed; documentation of investment strategy policies has been updated.

6.0 Highlights and Accomplishments

During the year 2010-11 the Sinking Fund had a net income of $47,951,000.

7.0 Opportunities and Challenges

The unpredictable nature of the investment market will continue to challenge the Board of Trustees to ensure that its investment strategy maximizes the rate of return earned on its investment portfolio while at the same time, protects the security of the sinking funds.

A slow global recovery continues during 2011. As the economies improve further, it is anticipated that there will be an opportunity to increase the earning potential of the investment portfolio.

8.0 Financial Statements

Please see attached.

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25 July 2011

Ref: DP04-F1311

Mr. Terry Paddon, CA
Chairperson
Board of Trustees
Newfoundland and Labrador Government
Sinking Fund
P.O. Box 8700
St. John's, Newfoundland and Labrador
A1B 4J6

RECEIVED
JUL 28 2011
DEPUTY MINISTER
DEPT. OF FINANCE

Dear Mr. Paddon:

I enclose six copies of the audited financial statements of the Newfoundland and Labrador Government Sinking Fund for the year ended 31 March 2011. After signing, please return the unbound copy to me.

The Comptroller General, Department of Finance, has indicated that a signed copy of the audited financial statements should also be forwarded to that Office.

Yours truly,

JOHN L. NOSEWORTHY, CA
Auditor General

Enclosure

c.c. Honourable Thomas W. Marshall, Q.C.
Minister of Finance and President
of Treasury Board

Mr. Ronald Williams, CA
Comptroller General

NEWFOUNDLAND AND LABRADOR
GOVERNMENT SINKING FUND

FINANCIAL STATEMENTS

31 MARCH 2011

OFFICE OF THE AUDITOR GENERAL
St. John's, Newfoundland and Labrador

AUDITOR'S REPORT

To the Board of Trustees
Newfoundland and Labrador Government Sinking Fund
St. John's, Newfoundland and Labrador

Report on the Financial Statements

I have audited the accompanying financial statements of the Newfoundland and Labrador Government Sinking Fund, which comprise the balance sheet as at 31 March 2011 and the statements of statutory contributions, retained earnings, revenues and expenses and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

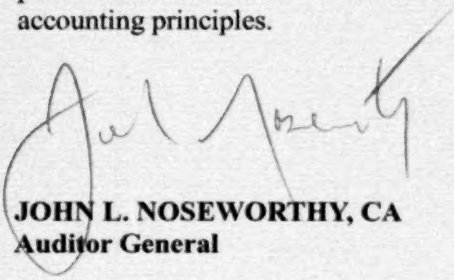
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Auditor's Report (cont.)

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the Newfoundland and Labrador Government Sinking Fund as at 31 March 2011, and its financial performance and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.



JOHN L. NOSEWORTHY, CA
Auditor General

30 June 2011
St. John's, Newfoundland and Labrador

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
INDEX TO FINANCIAL STATEMENTS
31 March 2011

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Statement of Cash Flows	" 5
Schedule of Investments	Schedule 1

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND

BALANCE SHEET

31 March	2011 (000's)	2010 (000's)
ASSETS		
Current		
Cash	$ 22,268	$ 39,538
Term deposits and short-term investments	6,011	11,885
Interest and other receivables		
Province of Newfoundland and Labrador - guaranteed	9,376	9,629
Other	3,416	2,556
	41,071	63,608
Investments, at amortized cost (Schedule 1)		
Cost	768,799	691,880
Accumulated amortization of discounts and premiums	114,723	100,978
	883,522	792,858
	$ 924,593	$ 856,466
LIABILITIES AND SINKING FUND EQUITY		
Current		
Accounts payable and accrued liabilities	$ 11	$ 13
Due to Province of Newfoundland and Labrador	259	219
	270	232
Sinking fund equity		
Statutory contributions (Statement 2)	525,239	487,319
Retained earnings (Statement 3)	399,084	368,915
	924,323	856,234
	$ 924,593	$ 856,466

See accompanying notes

Signed on behalf of the Board:

Chairperson **Member**

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF STATUTORY CONTRIBUTIONS
For the Year Ended 31 March

	2011	2010
	(000's)	(000's)
Balance, beginning of year	**$ 487,319**	$ 489,231
Statutory contributions for the year	**48,352**	51,187
	535,671	540,418
Statutory contributions applicable to matured/redeemed debentures	**(4,311)**	(22,350)
Foreign currency translation adjustment (Note 2)	**(6,121)**	(30,749)
Balance, end of year	**$ 525,239**	$ 487,319

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF RETAINED EARNINGS
For the Year Ended 31 March

	2011	2010
	(000's)	(000's)
Balance, beginning of year	**$ 368,915**	$ 387,290
Excess of revenues over expenses	**47,951**	43,332
	416,866	430,622
Retained earnings applicable to matured/redeemed debentures	**(12,016)**	(36,329)
Foreign currency translation adjustment (Note 2)	**(5,766)**	(25,378)
Balance, end of year	**$ 399,084**	$ 368,915

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF REVENUES AND EXPENSES
For the Year Ended 31 March

	2011	2010
	(000's)	(000's)
REVENUES		
Interest income		
Debentures	$ 37,072	$ 38,000
Term deposits and short-term investments	34	1
Other	348	256
	37,454	38,257
Foreign currency translation losses (Note 2)	(1,203)	(5,248)
Amortization of discounts and premiums	12,300	10,568
Loss on redemption/sales	(342)	-
	48,209	43,577
EXPENSES		
Salaries and benefits	152	145
General	106	100
	258	245
Excess of revenues over expenses	$ 47,951	$ 43,332

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF CASH FLOWS
For the Year Ended 31 March

	2011	2010
	(000's)	(000's)
Cash flows from operating activities		
Excess of revenues over expenses	$ 47,951	$ 43,332
Adjustment for non-cash items		
Amortization of discounts and premiums	(12,300)	(10,568)
Foreign currency translation losses (Note 2)	1,203	5,248
Loss on redemption/sales	342	-
	37,196	38,012
Change in non-cash working capital	(569)	1,104
	36,627	39,116
Cash flows from financing activities		
Statutory contributions	48,352	51,187
Cash flows from investing activities		
Purchase of investments	(100,401)	(64,877)
Proceeds from redemption and sale of investments	-	54,964
Payments of excess to Province upon maturing debentures	(6,065)	(58,679)
	(106,466)	(68,592)
Net (decrease) increase in cash and cash equivalents	(21,487)	21,711
Effect of foreign currency translation adjustment (Note 2)	(1,657)	(2,634)
Cash and cash equivalents, beginning of year	51,423	32,346
Cash and cash equivalents, end of year	$ 28,279	$ 51,423
Cash and cash equivalents include:		
Cash	$ 22,268	$ 39,538
Term deposits and short-term investments	6,011	11,885
	$ 28,279	$ 51,423

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
SCHEDULE OF INVESTMENTS
31 March

	2011		2010	
	Face Value or Par (000's)	**Amortized Cost (000's)**	Face Value or Par (000's)	Amortized Cost (000's)
Canadian				
Province of Newfoundland and Labrador - guaranteed				
Province of Newfoundland and Labrador	**$ 143,660**	**$ 153,106**	$ 151,195	$ 161,426
Newfoundland and Labrador Municipal Financing Corporation	**19,350**	**19,346**	19,350	19,342
Newfoundland and Labrador Hydro	**30,248**	**35,678**	30,248	35,977
Coupons and residuals	**311,940**	**191,488**	311,456	180,358
	505,198	**399,618**	512,249	397,103
Other securities	**110,760**	**115,994**	77,667	80,111
Other coupons and residuals	**185,963**	**98,473**	109,570	61,600
	801,921	**614,085**	699,486	538,814
U.S.				
Province of Newfoundland and Labrador - guaranteed				
Province of Newfoundland and Labrador	**120,477**	**134,534**	124,999	140,672
Other securities	**97,080**	**120,205**	81,690	98,869
Other coupons and residuals	**23,121**	**14,698**	24,222	14,503
	240,678	**269,437**	230,911	254,044
Total investments	**$ 1,042,599**	**$ 883,522**	$ 930,397	$ 792,858

See accompanying notes

Authority

The Province of Newfoundland and Labrador issues debentures, most of which have sinking fund requirements. For debentures which have sinking fund requirements, the Province makes the required sinking fund payments (statutory contributions) to the Board of Trustees of the Newfoundland and Labrador Government Sinking Fund. This is an unincorporated body formed under the *Financial Administration Act.* All members of the Board are full-time employees of the Province and are appointed by the Lieutenant-Governor in Council.

1. Summary of significant accounting policies

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Outlined below are the significant policies followed.

(a) Cash and cash equivalents

Cash and cash equivalents include balances with banks, and term deposits and short-term investments with original maturities of three months or less.

Short-term deposits are recorded at cost which approximates market value because of the short-term nature of the securities.

(b) Investment transactions

(i) Purchases: Investments are initially recorded at cost.

(ii) Amortization: Discounts and premiums are amortized on a straight-line basis from the date of purchase until maturity.

(iii) Sales: Sales of investments are at a negotiated selling price. Sales are recorded at the proceeds less the investment's average amortized cost, with any resulting gain or loss also recorded.

(iv) Redemptions: On occasion, investments held in the Fund will be called for redemption by the issuer. In such instances, a gain is recorded equal to the redemption proceeds less the investment's average amortized cost.

1. Summary of significant accounting policies (cont.)

(c) Maturity of a Province of Newfoundland and Labrador debenture issue for which a sinking fund has been provided

(i) General

Provision is made for redemption at debenture maturity by investing statutory contributions in interest bearing securities and other investments. Both the contributions and the interest are used to pay debenture holders when debentures mature.

A record is maintained of statutory contributions received on account of each issue and of income allocated to each issue (retained earnings). The dollar total of an issue's statutory contributions and allocated income is called its Sinking Fund Value.

At maturity, statutory contributions are reduced by the total amount of statutory contributions received over the life of the issue. Retained earnings are reduced by the excess of the debenture's Sinking Fund Value over statutory contributions received.

(ii) Cash flow

At maturity, cash is paid into a redemption bank account in an amount equal to the lesser of the total face value of the issue or the Sinking Fund Value of the issue, less the face value of the issue held in the Fund's investments. If the issue's Sinking Fund Value exceeds the total face value, the excess is paid to the Consolidated Revenue Fund of the Province of Newfoundland and Labrador. If the issue's Sinking Fund Value is less than the total face value, the difference is paid into the redemption bank account by the Province.

(d) Cancellation of Province of Newfoundland and Labrador debentures held by the Sinking Fund upon related sinking fund debentures becoming fully funded

When the value of a sinking fund for a debenture issue equates to the outstanding principal amount of that issue, the Sinking Fund will return to the Province for cancellation any debentures of that issue held by the Sinking Fund. The cancellation of sinking fund assets results in a corresponding reduction in sinking fund equity. Interest income continues to be allocated to the sinking fund until maturity of the related debenture issue and is returned to the Province annually.

(e) Interest income

Interest income is recorded on an accrual basis.

(f) Foreign currency translation

Assets, liabilities, revenues and expenses denominated in U.S. currency are translated as follows:

(i) assets and liabilities are translated at the rate of exchange in effect at the balance sheet date; and

1. Summary of significant accounting policies (cont.)

(f) Foreign currency translation (cont.)

(ii) revenues and expenses are translated at the rate of exchange in effect on the dates on which such items are recognized in income during the year, or an average of such.

Gains and losses resulting from foreign currency translation are amortized on a straight-line basis over the remaining life of each issue's sinking fund.

2. Effect of foreign currency translation

At 31 March 2011, the Fund held $883,522,000 (2010 - $792,858,000) in investments as shown in Schedule 1. These investments include $269,437,000 in U.S. investments (2010 - $254,044,000).

The Fund assets, liabilities, statutory contributions and retained earnings denominated in U.S. currency are translated at the rate of exchange in effect at the balance sheet date. The Fund's revenues and expenses are translated at the rate of exchange in effect on the dates on which such items are recognized in income during the year, or an average of such. It is not the intention of the Fund that its U.S. assets will be converted into Canadian dollars.

In 2011 and 2010, the translation of U.S. assets at year end resulted in a net foreign exchange loss due to a decrease in the value of the U.S. dollar. Any gains or losses resulting from foreign currency translations will not become realized until such time that U.S. assets should ever actually be converted to Canadian dollars.

		2011 (000's)		2010 (000's)
The effect of the translation is as follows:				
Statutory contributions have been decreased by	**$**	**(6,121)**	$	(30,749)
Retained earnings have been decreased by		**(5,766)**		(25,378)
Excess of revenues over expenses has been decreased by		**(1,203)**		(5,248)
Total impact of foreign currency translation		**(13,090)**		(61,375)
The effect of this amount on the Fund assets is as follows:				
Investments have been decreased by		**(11,433)**		(58,741)
Cash and cash equivalents have been decreased by	**$**	**(1,657)**	$	(2,634)

3. Financial instruments

The Newfoundland and Labrador Government Sinking Fund's short-term financial instruments recognized on the balance sheet consist of cash, term deposits and short-term investments, interest and other receivables, accounts payable and accrued liabilities, and due to Province of Newfoundland and Labrador. The carrying values of these instruments approximate current fair value due to their nature and the short-term maturity associated with them.

The Fund holds long-term investments which have an amortized cost of $883,522,000 (2010 - $792,858,000). The face value of these investments is $1,042,599,000 (2010 - $930,397,000). The policy and intention of the Board is to hold these long-term investments to maturity. Therefore, their reported value is current fair value to the Fund and there is no rate risk associated with these investments.

4. Income taxes

The Newfoundland and Labrador Government Sinking Fund is a Crown entity of the Province of Newfoundland and Labrador and as such is not subject to Provincial or Federal income taxes.